2007

University of Maine System Annual Financial Report

University Of Maine System

Maine's Public Universities

UNIVERSITY OF MAINE SYSTEM

ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2007

Additional copies are available at http://www.maine.edu/system/oft/finance_treasurer.php or by contacting:

Office of Finance and Treasurer
16 Central Street
Bangor, ME 04401-5106

In complying with the letter and spirit of applicable laws and in pursuing its own goals of diversity, the University of Maine System shall not discriminate on the grounds of race, color, religion, sex, sexual orientation, including transgender status or gender expression, national origin or citizenship status, age, disability, or veterans status in employment, education, and all other areas of the University. The University provides reasonable accommodations to qualified individuals with disabilities upon request.

Questions and complaints about discrimination in any area of the University should be directed to Sally Dobres, Director of Equity and Diversity, University of Maine System, Office of Human Resources, 16 Central Street, Bangor, Maine 04401-5106 (207) 973-3372 (voice) or (207) 973-3262 (TTY/TDD). Inquiries or complaints about discrimination in employment or education may also be referred to the Maine Human Rights Commission. Inquiries or complaints about discrimination in employment may be referred to the U.S. Equal Employment Opportunity Commission.

Inquiries about the University's compliance with Title VI of the Civil Rights Act of 1964, which prohibits discrimination on the basis of race, color, and national origin; Section 504 of the Rehabilitation Act of 1973 and Title II of the Americans with Disabilities Act of 1990, which prohibit discrimination on the basis of disability; Title IX of the Education Amendments of 1972, which prohibits discrimination on the basis of sex; and the Age Discrimination Act of 1975, which prohibits discrimination on the basis of age, may also be referred to the U.S. Department of Education, Office for Civil Rights (OCR), Boston, MA 02110-1491, telephone (617) 289-0111 (voice) or (617) 289-0150 (TTY/TDD). Generally, an individual may also file a complaint with OCR within 180 days of alleged discrimination.

UNIVERSITY OF MAINE SYSTEM

Office of the Chancellor
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November 2007

Dear Friend:

The University of Maine System touches every Maine community and provides a powerful influence on Maine's economy, quality of life, and educational opportunities. Our System includes seven universities, 10 academic outreach centers, more than 45,000 students, 5,000 employees and 100,000 alumni living in Maine.

This enclosed financial report presents just one view of the positive impact that our public universities have in Maine. A recent economic impact report notes that the University of Maine System has an annual economic impact of $1.5 billion. The report also shows that the System generates $8.10 of economic activity in Maine for every one dollar of state appropriation—that's an 8:1 return on investment and substantial impact on our state's economy.

The expertise of our faculty, staff, and students also contributes immensely to the State's economic, educational, and cultural well-being. In FY 2006 alone, this work resulted in $74 million in federal and private sector grants and contracts for research which covers a wide array of topics.

In addition, faculty, staff, and students at our universities work in other ways to improve Maine's quality of life through numerous programs such as the Cooperative Extension Service, Small Business Development Centers, Center for Community Inclusion, Senior College, and Institute on Rural Poverty, as well as providing cultural and educational opportunities throughout the state.

In this, my first year as chancellor, I am developing an "Agenda for Action" which outlines my focus for the upcoming years. This plan includes five areas of focus: student success, strengthen Maine's economy, environmental leadership, lead as a higher education voice, and ensure the financial sustainability of the University of Maine System. In this last area of focus, the System will undergo a multi-year financial planning process that will allow it to continue as a financially stable enterprise for years to come.

As the state's public university system, we are fully accountable to the citizens of Maine. The enclosed annual report summarizes the University of Maine System's solid financial condition and our compliance with nationally accepted financial accounting standards.

I hope that you find this report informative and comprehensive. Additional information is available on our web site www.maine.edu. Please contact me if you have any questions or concerns.

Sincerely,

Richard L. Pattenaude
Chancellor

KPMG LLP
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Independent Auditors' Report

The Board of Trustees
University of Maine System:

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of the University of Maine System (the System), a component unit of the State of Maine, as of and for the years ended June 30, 2007 and 2006, which collectively comprise the System's basic financial statements as shown on pages 18 through 49. These financial statements are the responsibility of the System's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the aggregate discretely presented component units, are based on the reports of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the aggregate discretely presented component units were not audited in accordance with *Government Auditing Standards.* An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of the System as of June 30, 2007 and 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2007 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 5 through 17 and the supplementary schedules of funding progress and employers' contributions on page 50 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements taken as a whole. The accompanying schedules of activities (Schedules 1 and 2) on page 51 for the years ended June 30, 2007 and 2006 are presented for purposes of additional analysis as required by the State of Maine and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

October 26, 2007

Management's Discussion and Analysis (unaudited)
June 30, 2007 and 2006

The following unaudited Management's Discussion and Analysis (MD&A) has been prepared by University of Maine System ("the System") management to provide users with a narrative and analysis of the System's financial position based on currently known facts, decisions, and conditions. This discussion includes an analysis of the financial condition and results of activities of the System for the fiscal years ended June 30, 2007 and prior years. As this presentation includes highly summarized information, it should be read in conjunction with the accompanying basic financial statements and related notes.

MISSION

The University of Maine System unites seven distinctive public universities in the common purposes of providing first-rate higher education at reasonable cost in order to improve the quality of life for the citizens of Maine. The System, through its Universities, carries out the traditional tripartite mission – teaching, research, and public service. As a System, it extends its mission as a major resource for the State, linking economic growth, the education of its people, and the application of research and scholarship.

UNIVERSITY OF MAINE SYSTEM UNIVERSITIES & CENTERS/COLLEGES

The University of Maine System is a comprehensive public institution of higher education serving more than 45,600 students and is supported by the efforts of 1,371 regular full-time faculty, 111 regular part-time faculty, 3,445 regular full-time staff, and 354 regular part-time staff members. Nationally recognized as a leader in combining excellence with access in public higher education, the System consists of the following seven universities:

- University of Maine (UM)
- University of Maine at Augusta (UMA)
- University of Maine at Farmington (UMF)
- University of Maine at Fort Kent (UMFK)
- University of Maine at Machias (UMM)
- University of Maine at Presque Isle (UMPI)
- University of Southern Maine (USM)

Lewiston-Auburn College is a campus of the University of Southern Maine. University College of Bangor is a campus of the University of Maine at Augusta. The Hutchinson Center in Belfast is a campus of the University of Maine.

University College offers access to quality public higher education statewide. Students may participate in interactive television (ITV) at dozens of sites throughout the State or may attend one of the ten University College locations below that offers both on-site and ITV instruction:

- Bath/Brunswick
- Dover-Foxcroft
- East Millinocket
- Ellsworth
- Houlton
- Norway/South Paris
- Saco/Biddeford
- Sanford
- Rockland
- Rumford/Mexico

Management's Discussion and Analysis (unaudited)

June 30, 2007 and 2006

STUDENT ENROLLMENT

For Fall 2006, the System experienced a less than 1% decrease in enrollment on both a headcount and full-time equivalent basis. 34,209 students were enrolled for the Fall 2006 semester, compared to 34,245 for the Fall 2005 semester. On a full-time equivalent basis, 24,227 were enrolled for the Fall 2006 semester, compared to 24,247 for the Fall 2005 semester. Consistent with prior years, 61% of the student population was enrolled full-time and 84% were Maine residents.

Table 1: Fall Student Enrollments

	FY 2007		FY 2006		FY 2005	FY 2004	FY 2003
Full-Time	**20,838**	**61%**	**20,777**	**61%**	20,714	20,419	19,623
Part-Time	**13,371**	**39%**	**13,468**	**39%**	13,539	13,956	14,466
Headcount	**34,209**	**100%**	**34,245**	**100%**	34,253	34,375	34,089
In-State	**20,299**	**84%**	**20,445**	**84%**	20,310	20,133	19,838
Out-of-State	**3,928**	**16%**	**3,802**	**16%**	3,808	3,805	3,531
Full-Time Equivalent	**24,227**	**100%**	**24,247**	**100%**	24,118	23,938	23,369

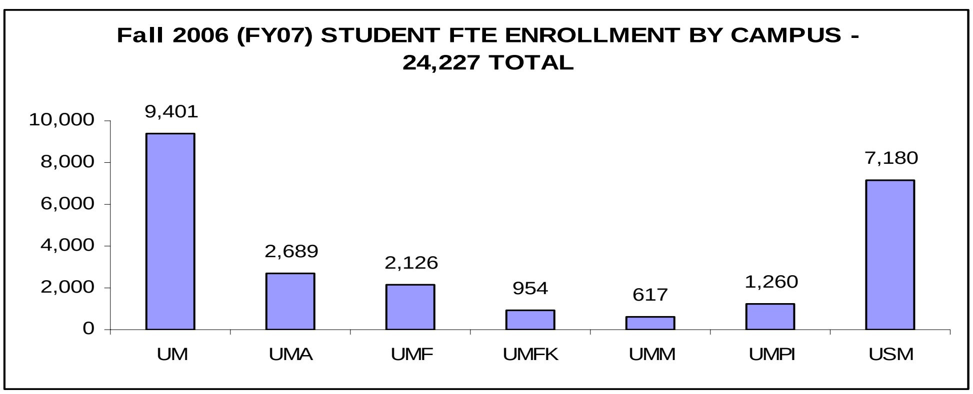


Table 2: Fall Student Enrollments - FTE

	FY 2007	FY 2006	FY 2005	FY 2004	FY 2003
UM	**9,401**	**9,204**	9,054	8,923	8,665
UMA	**2,689**	**2,759**	2,806	2,936	2,769
UMF	**2,126**	**2,149**	2,087	2,116	2,093
UMFK	**954**	**919**	907	779	708
UMM	**617**	**626**	666	754	680
UMPI	**1,260**	**1,242**	1,293	1,207	1,158
USM	**7,180**	**7,348**	7,305	7,223	7,296
Total	**24,227**	**24,247**	24,118	23,938	23,369

STUDENT COMPREHENSIVE COST OF EDUCATION

The weighted average comprehensive costs of education for UMS undergraduate, graduate and law school students are shown in Table 3 below. Increases in 2007 range from a high of 8.9% for graduate New England Board of Higher Education (NEBHE)/Canadian students to a low of 7.1% for graduate out-of-state students. In 2006, the increases range from a high of 10.8% for Law School NEBHE/Canadian students to a low of 4.7% for graduate NEBHE/Canadian students. The increases in costs of education reflect the moderate increases in State appropriation and increasing operating expenses.

Table 3: Student Comprehensive Cost of Education
Tuition, Mandatory Fees, and Room and Board
Weighted Averages

	2007		2006		2005		2004		2003	
Undergraduate										
In-State	$13,269	7.3%	$12,364	6.6%	$11,603	5.5%	$10,996	6.1%	$10,367	4.9%
Out-of-State	23,106	7.2%	21,559	8.1%	19,937	8.9%	18,315	6.8%	17,143	4.0%
NEBHE/Canadian *	15,341	7.8%	14,228	5.9%	13,432	2.2%	13,145	6.3%	12,363	4.9%
Graduate										
In-State	$12,408	7.2%	$11,573	6.5%	$10,863	5.2%	$10,329	5.5%	$9,790	3.7%
Out-of-State	22,067	7.1%	20,611	7.0%	19,257	6.4%	18,100	6.0%	17,071	3.7%
NEBHE/Canadian *	15,127	8.9%	13,889	4.7%	13,263	7.4%	12,344	5.8%	11,664	3.7%
Law School										
In-State	$24,017	7.6%	$22,319	10.2%	$20,245	9.9%	$18,417	7.7%	$17,106	5.4%
Out-of-State	33,507	7.3%	31,219	9.0%	28,645	7.5%	26,637	5.3%	25,296	4.6%
NEBHE/Canadian *	32,106	7.6%	29,839	10.8%	26,920	10.6%	24,329	8.1%	22,506	5.5%

* Weighted averages for 2005 through 2007 were calculated in a different manner than those for 2003 and 2004.

Management's Discussion and Analysis (unaudited)
June 30, 2007 and 2006

OVERVIEW OF THE FINANCIAL STATEMENTS

The University of Maine System's financial statements include three primary components, the:

- Statements of Net Assets,
- Statements of Revenues, Expenses, and Changes in Net Assets, and
- Statements of Cash Flows.

The University of Maine Foundation and the University of Maine Pulp and Paper Foundation are legally separate tax-exempt component units of the University of Maine System. These entities' financial position and activity are discretely presented in the University's financial statements as required by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. The MD&A includes information only for the System and not its component units. These financial statements are prepared in accordance with U. S. Generally Accepted Accounting Principles.

STATEMENTS OF NET ASSETS

The Statements of Net Assets present the financial position of the System at one point in time – June 30 – and include all assets and liabilities of the System. This statement is the primary statement used to report financial condition. Assets are measured at fair value, except for capital assets which are shown at historical cost less accumulated depreciation. Net assets represent the residual interest in the System's assets after liabilities are deducted. The change in net assets is an indicator of whether the overall financial condition has improved or deteriorated during the year. Table 4 on the following page shows Condensed Statements of Net Assets for the past five years

Total assets increased by $276 million, or 38%, over the past five years to a total of $995 million at June 30, 2007. Total assets are categorized as either current or noncurrent. Current assets are available to satisfy current liabilities, which in turn are those amounts expected to be payable within the next year. The major component of current assets is short-term investments which totals $137 million and $127 million at June 30, 2007 and 2006, respectively.

Noncurrent assets are comprised mainly of endowment investments and capital assets, net of depreciation. Endowment investments total $123 million at June 30, 2007, an increase of $15 million or 14% over 2006, and an increase of $45 million or 58% over 2003. Capital assets total $577 million and $519 million at June 30, 2007 and 2006, respectively. As noted later, the System is continually implementing its long-term capital plan to upgrade older facilities and construct new facilities when necessary.

Current liabilities are comprised primarily of accounts payable and various accrued liabilities including those for the System's workers compensation, health, and retirement plans. Noncurrent liabilities are composed primarily of bonds and notes payable.

Net assets increased $43 million and $34 million for the years ended June 30, 2007 and 2006, respectively. Over the past five years net assets have increased $155 million, or 33%.

Management's Discussion and Analysis (unaudited)
June 30, 2007 and 2006

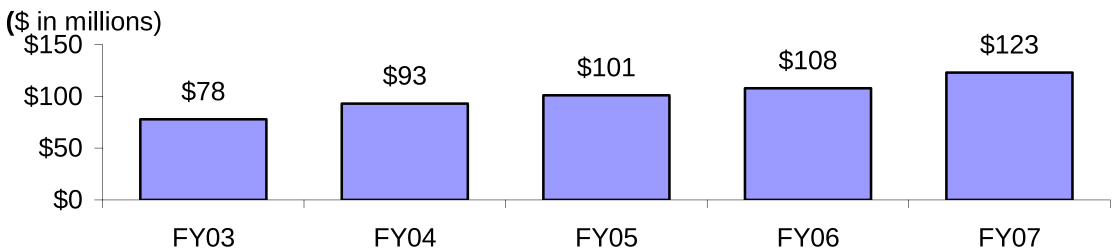
Table 4: Condensed Statements of Net Assets as of June 30
($ in millions)

	2007	2006	2005	2004	2003
Current Assets	**$188**	**$186**	$171	$169	$155
Noncurrent Assets					
Endowment investments	**123**	**108**	101	93	78
Capital assets, net	**577**	**519**	483	440	396
Other	**107**	**111**	70	84	90
Total Assets	**$995**	**$924**	$825	$786	$719
Current Liabilities	**$66**	**$71**	$61	$60	$55
Noncurrent Liabilities:					
Bonds and Notes Payable	**216**	**189**	136	141	122
Other	**82**	**76**	73	72	66
Total Liabilities	**364**	**336**	270	273	243
Invested in Capital Assets, net of relate	**396**	**379**	358	327	305
Restricted:					
Nonexpendable	**48**	**48**	48	47	44
Expendable	**111**	**99**	89	82	69
Unrestricted	**76**	**62**	60	57	58
Total Net Assets	**631**	**588**	555	513	476
Total Liabilities and Net Assets	**$995**	**$924**	$825	$786	$719

Pooled Endowment

Endowments are gifts received from donors who stipulate that the original amount of the gift (principal) cannot be expended but the income earned and related appreciation can be expended. If the donor established criteria to determine how the expendable amounts can be used, then the endowment is restricted. If the use of funds is left to the discretion of the System, the endowment income is considered unrestricted. The vast majority of gifts received by the System are placed in an investment pool along with funds held by the System for others such as the University of Southern Maine Foundation, and investment income is allocated to each endowed fund based on its pro-rata share of the pool.

MARKET VALUE OF POOLED ENDOWMENT INVESTMENTS



The System's pooled endowment investments had a fair value of $123 million at June 30, 2007 reflecting an increase of $15 million over the prior year fair value of $108 million. This increase is primarily attributable to gifts, market value appreciation, and income which all increased compared to the prior year. The June 30, 2006 fair value of $108 increased $7 million over the prior year which was primarily attributable to market value appreciation and income. Spending for scholarships and operations also increased during 2007 and 2006.

The pooled endowment investments are diversified among the following asset classes to minimize risk while optimizing return.

Table 5: Endowment Pool Asset Allocation Percentages at June 30

	2007	2006	2005	2004
Equity				
Domestic Equities	44%	41%	47%	48%
International Equities	20%	16%	15%	13%
Fixed Income				
Multi-Strategy Bond	15%	16%	17%	18%
High Yield Bond	4%	4%	6%	6%
Cash	0%	4%	0%	0%
Alternative				
Global Absolute Return	8%	8%	8%	7%
Market Neutral	6%	7%	7%	8%
Timber	3%	4%	0%	0%
	100%	100%	100%	100%

The System manages its endowment to generate a predictable stream of annual support for current needs, while at the same time preserving the endowment as a whole to ensure funds for future years. For 2007 and 2006, the annual distribution amount was computed using a formula that weights:

- The forecasted distribution amount (based on prior year spending increased by inflation) and
- The fund's most recent calendar year-end market value multiplied by a 5% spending rate.

Capital Assets and Debt Activities

The System's facilities are critical to accomplishing the mission of the System as they provide the physical framework and environment necessary to house educational, research, and cultural programs and residential life. The System is continually implementing its long-term capital plan, upgrading older facilities and constructing new facilities when necessary.

Capital additions of $81 million in 2007 and $57 million in 2006 primarily consist of replacement, renovation, and new construction of academic, housing, recreation/fitness centers, and research facilities as well as investments in equipment, including information technology. Capital asset additions in 2007 and 2006 were funded primarily with State of Maine capital appropriations, private gifts, and System revenue bonds.

Of the total capital additions for 2007, $72 million represents capital construction. Construction or renovation projects include the Student Recreation Center, Hilltop Commons Renovation projects, and installation of sprinkler systems in various residential halls at UM; the Gorham Residence Hall and University Commons projects at USM; and an Education Center project at UMF.

Of the total capital additions for 2006, $49 million represent capital construction. Construction or renovation projects include Lord Hall at UM, the Health Physical Complex at UMPI, Black Hall at UMF, and the Biosciences Building and the John Mitchell Center at USM. Sprinkler systems were installed in various residential halls at UM. Two modules of the PeopleSoft/Oracle implementation were put in-service while additional modules are in-progress. This software integrates information and business processes to enable the efficient and effective sharing of information throughout the organization.

The System strives to manage all of its financial resources effectively including the prudent use of debt to finance capital projects that support the System's mission, thereby placing the System in a better position to achieve its strategic goals. Total debt as of June 30, 2007 and 2006 was $224 million and $196 million, respectively. The $28 million increase in debt was primarily the result of the System's issuance of $47 million in revenue bonds in June 2007. These bonds were issued to fund various maintenance and renovation projects at UM and the University Commons project at USM, and to partially refinance $14 million from the 1998 Series A and 2004 Series A Revenue bonds which resulted in reduced debt service payments.

Table 6 below shows major capital projects in progress during 2007, including budgeted costs, which have been approved by the System's Board of Trustees. These projects are projected to be completed at various dates from 2007 through 2010.

Table 6: Major Approved Capital Project in Progress during 2007

Campus	Project	Budgeted Cost ($ in millions)
UM	Dining Hall Renovations - Hilltop	$7.2
	Dining Hall Renovations - Wells	12.2
	Laboratory for Surface Science Technology	2.0
	Residential Hall Renovations	21.8
	Recreation Center	25.1
	Maine Center for the Arts - Phase I	8.0
	Major Maintenance Projects	4.4
	Hutchinson Center	4.0
UMA	Michael Klahr Center	2.9
	UCB Camden Hall Fit Out	1.3
USM	DOE Toxicology Lab Expansion	1.3
	Lewiston-Auburn New Building	4.0
	Gorham Child Care	1.3
	University Commons	21.0
	Residence Hall Gorham	21.5
ALL	Various projects supported by the State Bond Referendum passed in November 2007	23.0
	TOTAL	$161.00

Net Assets

Invested in capital assets, net of related debt, represent the historical cost of the System's capital assets reduced by total accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. The 2007 increase of $17 million and the 2006 increase of $21 million in this category of net assets reflects the System's renewal and expansion of its capital assets.

Restricted-nonexpendable net assets represent the System's permanent endowment funds. Items that impact this category of net assets include new endowment gifts, the transfer of endowment funds to UMS Foundations, and fair value fluctuations for those endowments whose fair value has fallen below the endowment corpus amount.

Restricted-expendable net assets include unexpended gifts and endowment appreciation subject to externally imposed conditions on spending. These net assets are restricted for a wide variety of purposes including student financial aid, capital asset acquisitions, research, and public service. The increase of $12 million in 2007 and $10 million in 2006 is primarily the result of positive market conditions impacting the endowment fund.

Unrestricted net assets are not subject to externally imposed stipulations; however, these assets have been committed to specific projects, operational and capital needs, or endowment funds for committed scholarships. Given both the physical and financial size of the University of Maine System, funds must be readily available to meet emergency needs, fund accounting pronouncement requirements, cover occasional annual operating losses and over-expenditures on capital projects, fund severance arrangements during periods of restructuring, and address an excessive maintenance backlog.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The total change in the System's net assets for the year is reported in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement reports total operating revenues, operating expenses, other revenues and expenses, and other changes in net assets. The System's total net assets increased $43 million in FY2007 compared with $33 million in FY2006. Table 7 on the next page shows Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the past five fiscal years ended June 30.

There are three major components which management considers separately when analyzing the change in net assets: net income (loss) from recurring activities; capital appropriations and other plant changes; and endowment gifts and unutilized total returns. The net income (loss) from recurring activities is further broken down into operating revenues, operating expenses, and other revenues (expenses).

Table 7: Condensed Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30
($ in millions)

	2007	2006	2005	2004	2003
Operating Revenues	**$406**	**$395**	$380	$368	$340
Operating Expenses	**(605)**	**(591)**	(568)	(552)	(528)
Operating Loss	**(199)**	**(196)**	(188)	(184)	(188)
Nonoperating Revenues (Expenses)					
Noncapital State of Maine Appropriations	**192**	**185**	180	172	173
Gifts Currently Expendable	**13**	**12**	11	10	12
Endowment Return Used for Operations	**5**	**4**	4	5	5
Investment Income	**10**	**8**	6	2	9
Interest and Other Expense	**(5)**	**(5)**	(4)	(5)	(4)
Net Nonoperating Revenue	**215**	**204**	197	184	195
Income Before Other Changes in Net Assets	**16**	**8**	9	0	7
Other Changes in Net Assets					
State of Maine Capital Appropriation	**10**	**13**	18	21	12
Capital Grants and Gifts	**8**	**5**	8	5	2
Endowment Return, Net of Amount Used for Operations	**11**	**5**	4	10	(2)
Other	**(2)**	**3**	2	1	2
Total Other Changes in Net Assets	**27**	**26**	32	37	14
Increase in Net Assets	**$43**	**$34**	$41	$37	$21

Operating and Nonoperating Revenue

In addition to receiving tuition and fees, the System receives revenue from several other diverse sources such as governmental and privately funded sponsored programs, gifts from individuals, foundations, and corporations, state appropriations, and investment income.

Revenues and expenses are categorized as either operating or non-operating. Certain significant recurring revenues and expenses including state appropriations, gifts, investment income or loss, and interest expense are considered non-operating. Scholarships and fellowships applied to student accounts are shown as a reduction of student tuition & fees and residence & dining fees revenues, while stipends and other payments made directly to students are presented as student aid expenses.

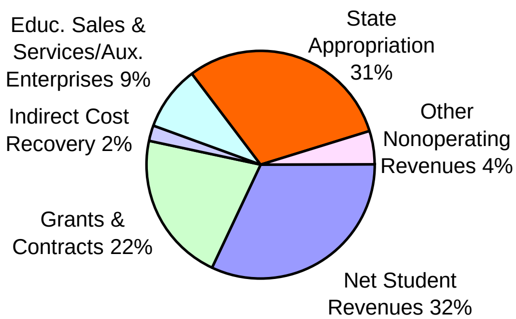
The following graph illustrates both the operating and non-operating revenue sources used to fund the System's activities for the years ended June 30, 2007 and 2006.

Management's Discussion and Analysis (unaudited)

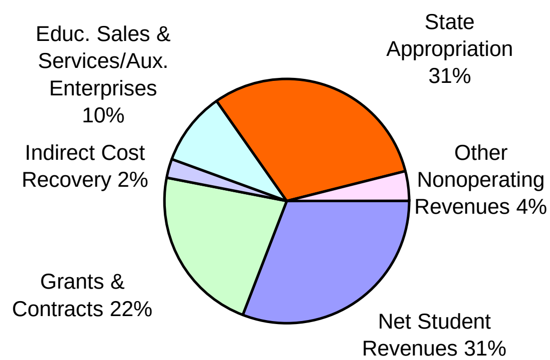
June 30, 2007 and 2006

TOTAL OPERATING & NONOPERATING REVENUE

2007 - $627 million



2006 - $604 million



Tuition and fees and residence and dining fees are the primary sources of operating revenues and in 2007 totaled $200 million after adjusting for scholarship allowances, reflecting an increase of $13 million or 7% over 2006 revenue of $187 million. This change is the result of a 9% weighted average increase in undergraduate in-state tuition and fees and a 6% weighted average increase in room and board rates.

Tuition and fees and residence and dining fees in 2006 totaled $187 million after adjusting for scholarship allowances, reflecting an increase of $13 million or 7% over 2005 revenue of $174 million. This change is the result of an 8% weighted average increase in undergraduate in-state tuition and fees and a 6% increase in room and board rates.

Financial aid awards are based on a student's financial need compared with their total cost of education which includes tuition and fees, housing and meals (both on and off campus), books, and other personal living expenses. Financial aid is composed of two components on the Statements of Revenues, Expenses, and Changes in Net Assets:

1. Scholarship Allowances – financial aid retained by the System to cover students' tuition, fees, and on-campus housing and meals.
2. Student Aid Expense – financial aid refunded to students to cover off-campus living costs, books, and other personal living expenses.

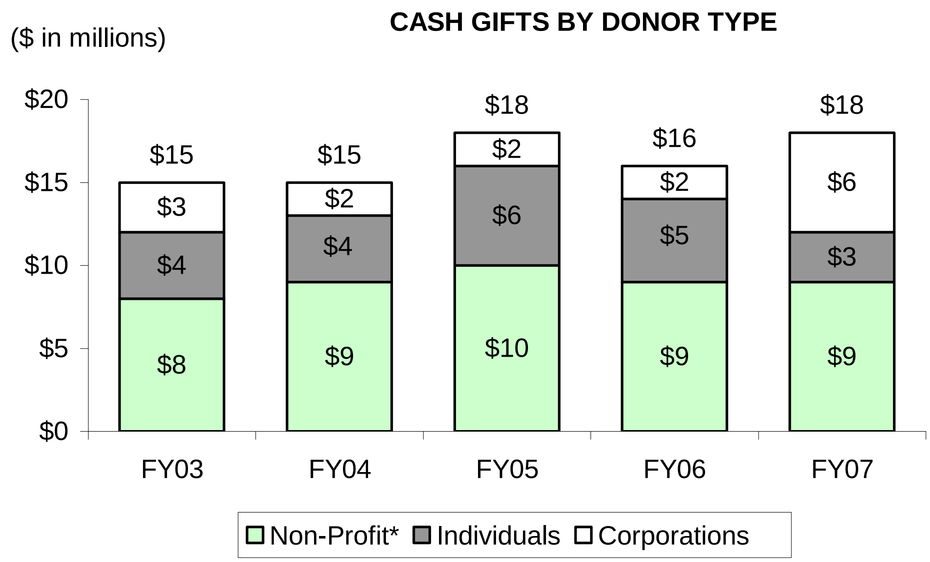
In 2007, the total financial aid provided was $73 million, a 9% increase over 2006 aid of $67 million. Total financial aid provided in 2006 reflected an increase of 3% when compared to total aid of $65 million in 2005.

Grants and contracts revenues of $135 million in 2007 increased $1 million over 2006 revenues of $134 million. The 2006 revenue decreased $1 million from 2005 revenues of $135 million. Grants and contracts revenues are recognized to the extent of related expenses. Consequently, reported revenues will fluctuate based on the timing of expenses across fiscal years. The System receives funding from federal, state, and private sources with the majority of the funding being provided by the federal government for research activities. Funding received from these sources also provides for recovery of indirect costs associated with sponsored programs. State research and development funding is used to leverage federal dollars.

State appropriation revenue includes amounts for general operations as well as amounts legislatively earmarked for research and development, financial aid, and various other areas. Although not considered an operating revenue, the noncapital State appropriation was the second largest funding source for educational and general operations. When compared to fiscal year 2006, the state appropriation increased by $7 million or 4.0% compared to an increase of $5 million or 3% for 2006. For fiscal years 2007 and 2006, the general state appropriation covered 97% and 94% respectively of the net operating losses.

Gifts

Total gifts received increased $2 million during 2007, compared to 2006, whereas total gifts received had declined by $2 million in 2006 compared to 2005.



*Non-Profit includes foundations, governmental agencies, and other non-profit groups

Operating Expenses

Table 8: Operating Expenses, Classified by Function
For the Years Ended June 30
($ in millions)

	2007		2006		2005	
Instruction	**$168**	**29%**	**$159**	**27%**	$154	27%
Research	**71**	**12%**	**72**	**12%**	73	13%
Public Service	**53**	**9%**	**53**	**9%**	50	9%
Academic support	**66**	**11%**	**61**	**10%**	66	12%
Student services	**45**	**7%**	**44**	**8%**	42	7%
Institutional support	**43**	**7%**	**43**	**7%**	38	7%
Operation and maintenance of plant	**46**	**7%**	**45**	**8%**	39	7%
Depreciation and amortization	**21**	**3%**	**20**	**3%**	20	3%
Student aid	**20**	**3%**	**20**	**3%**	19	3%
Auxiliary enterprises	**72**	**12%**	**74**	**13%**	67	12%
Total Operating Expenses	**$605**	**100%**	**$591**	**100%**	$568	100%

Although the System reports expenses on a functional basis, Table 9 presents the comparative summary of the System's expenses based on a natural classification.

Table 9: Total Expenses by Natural Classification
For the Years Ended June 30
($ in millions)

	2007		2006		2005	
Operating:						
Compensation and benefits	**$388**	**64%**	**$373**	**63%**	$356	62%
Utilities	**30**	**5%**	**28**	**5%**	25	4%
Supplies and services	**146**	**24%**	**150**	**25%**	148	26%
Depreciation	**21**	**3%**	**20**	**3%**	20	4%
Student aid	**20**	**3%**	**20**	**3%**	19	3%
	605	**99%**	**591**	**99%**	568	99%
Nonoperating:						
Interest	**6**	**1%**	**5**	**1%**	4	1%
Total Expenses	**$611**	**100%**	**$596**	**100%**	$572	100%

The amount expended for compensation and benefits increased by $15 million or 4% for 2007 as compared to an increase of $17 million or 5% for 2006. This increase in 2007 and 2006 is the result of increased health care costs, employee compensation increases, and employment growth. The System continues to work with the State of Maine and other employers to minimize health care costs while also providing quality health-care coverage to employees and retirees.

IMPACT OF FUTURE ECONOMIC FACTORS

The University of Maine System continues to maintain high-quality academic programs and services and to position itself to meet the needs of Maine citizens in the future while confronting the challenges of rising costs, evolving educational methodologies, and a changing economy.

Total enrollments at the System had been steadily increasing since 1997 with a record FTE enrollment for the Fall 2005 semester. Enrollments leveled off in the Fall 2006 at approximately 24,200 Full Time Equivalents. Projections indicate that the number of Maine high school graduates will decline over the next few years; therefore, the System is proactively pursuing increased student enrollment and retention efforts at each institution while assisting prospective students with the transition to university life.

Recruitment efforts include expansions and/or enhancements in the following areas:
- Strategic use of financial aid
- On-line application capabilities
- Out of state recruitment activity, including a system-wide marketing campaign
- Web tools and institutional web sites
- Specialty areas recruitments (music, sports, etc.)
- Advising efforts on all campuses including system-wide advising conferences

- Recruitment and advising of students intending to transfer from community colleges
- Exposing high school students to UMS institutions through early-study and early-college opportunities

Retention efforts include:

- Development and implementation of student success programs funded by MELMAC Educational Foundation Student Success Grants
- Participation in the National Survey of Student Engagement (students surveyed as freshmen and then again as seniors)
- Alignment and expansion of curricular and co-curricular experiences to further engage students and enhance course work

From a fiscal perspective, the most significant economic factor is the State of Maine's fiscal performance and its impact on the System. Although the System experienced declining state appropriation during 2003 and 2004, the appropriation received during 2005 increased by 4.7% and reflected the restoration of previously deappropriated funds. For 2006, the state appropriation increased by 2.7% above 2005 levels and for 2007 it increased 4%. The 2008 General Fund appropriation is scheduled to increase by approximately $9.5 million or 5% above FY2007 levels. Although state funding has been increasing, the funding has not been adequate to offset rising educational costs resulting in the System implementing a weighted average tuition increase of 9.8% for 2008. The System is continuing to seek additional state support and supplemental revenue sources to alleviate the costs paid by students and to reduce expenses through cost cutting efforts.

The System currently provides medical benefits to disabled and retired employees and their spouses and dependents and accounts for the benefits on a cash basis. Effective for fiscal year 2008, GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* will mandate the use of accrual accounting and actuarial valuations. To prepare for the future implementation of this Statement, the System has selected an independent actuary to analyze the GASB requirements, collect data, analyze the data, and provide the actuarial determined unrecorded liability.

A Retiree Health Plan Task Force, comprised of faculty and administrators, staff employees, retirees, representatives of the Board of Trustees and the System's bargaining agents, was formed with a final report and recommendations submitted to the Chancellor on June 30, 2007. The System is currently reviewing the recommendations in this report and strategies to reduce the cost of postemployment medical benefits.

Currently campus budgets do not fully fund depreciation with facilities' capital maintenance needs being funded primarily with operating surpluses, which has resulted in a depreciation "gap" that is increasing annually. During 2005, the Maine Legislature did increase the System's tax exempt borrowing authority to $220 million from $170 million, but the System continues to seek State Capital Appropriations and State Bond financing to address this situation. In fiscal year 2007, the System received $3 million in State Capital Appropriation to fund a high speed Regional Optical Network focused primarily on research needs and in November 2007, a State of Maine Higher Education Bond totaling $23 million for the System was passed by voters.

UNIVERSITY OF MAINE SYSTEM
Statements of Net Assets
As of June 30, 2007 and 2006
($ in thousands)

	2007 University of Maine System	2006 University of Maine System	2007 Component Units	2006 Component Units
ASSETS				
Current Assets:				
Cash and cash equivalents	$ 1,641	$ 8,378	$ 110	$ 53
Short-term investments	137,373	127,466	1,946	1,744
Accounts, grants, and pledges receivable, net	42,067	44,177	1,081	686
Inventories and prepaid expenses	7,193	5,757	-	-
Notes receivable, net	61	489	-	-
Total Current Assets	188,335	186,267	3,137	2,483
Noncurrent Assets:				
Deposits with bond trustees	57,992	61,128	-	-
Accounts, grants, and pledges receivable, net	6,192	6,241	1,239	1,182
Notes receivable, net	40,800	41,114	-	-
Endowment and other investments	123,014	107,976	188,738	147,255
Bond issuance costs, net	2,241	2,198	-	-
Capital assets, net	576,909	519,273	112	94
Other assets	-	-	17,753	16,924
Total Noncurrent Assets	807,148	737,930	207,842	165,455
Total Assets	$ 995,483	$ 924,197	$ 210,979	$ 167,938
LIABILITIES				
Current Liabilities:				
Accounts payable	$ 19,156	$ 18,290	$ 63	$ 33
Deferred revenue and deposits	17,207	17,964	-	-
Accrued liabilities	22,319	27,242	-	-
Funds held for others	719	606	-	-
Current portion of capital lease obligations	346	223	-	-
Current portion of bonds and note payable	6,453	6,329	54	53
Total Current Liabilities	66,200	70,654	117	86
Noncurrent Liabilities:				
Accrued liabilities	37,613	35,527	835	799
Funds held for others	11,570	8,132	-	-
Capital lease obligations	766	364	-	-
Bonds and note payable, net	216,214	189,468	686	722
Government advances refundable	31,292	31,514	-	-
Other Liabilities	-	-	5,673	3,111
Total Noncurrent Liabilities	297,455	265,005	7,194	4,632
Total Liabilities	363,655	335,659	7,311	4,718
NET ASSETS				
Invested in capital assets, net of related debt	396,244	379,235	75	52
Restricted:			-	-
Nonexpendable	48,864	48,153	128,827	109,536
Expendable	110,863	99,414	54,550	40,874
Unrestricted	75,857	61,736	20,216	12,758
Total Net Assets	631,828	588,538	203,668	163,220
Total Liabilities and Net Assets	$ 995,483	$ 924,197	$ 210,979	$ 167,938

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2007 and 2006
($ in thousands)

	2007 University of Maine System	2006 University of Maine System	2007 Component Units	2006 Component Units
OPERATING REVENUES				
Tuition and fees	$ 198,540	$ 182,616	$ -	$ -
Residence and dining fees	53,341	51,491	-	-
Less: scholarship allowances	(52,227)	(47,454)	-	-
Net student fees	199,654	186,653	-	-
Federal, state, and private grants and contracts	135,317	134,135	-	-
Recovery of indirect costs	13,584	13,963	-	-
Educational sales and services and other revenues	30,066	31,405	209	232
Other auxiliary enterprises	27,167	29,053	-	-
Total Operating Revenues	405,788	395,209	209	232
OPERATING EXPENSES				
Instruction	167,893	159,341	-	-
Research	71,316	71,853	-	-
Public service	52,872	53,411	-	-
Academic support	65,439	61,154	-	-
Student services	45,262	43,577	-	-
Institutional support	42,370	43,367	2,839	2,274
Operation and maintenance of plant	46,014	44,985	-	-
Depreciation and amortization	21,412	20,325	21	22
Student aid	20,342	19,503	421	487
Auxiliary enterprises	71,641	73,650	-	-
Total Operating Expenses	604,561	591,166	3,281	2,783
Operating Loss	(198,773)	(195,957)	(3,072)	(2,551)
NONOPERATING REVENUES (EXPENSES)				
Noncapital State of Maine appropriations	192,119	184,688	-	-
Gifts currently expendable	13,296	12,121	5,233	1,254
Payments to the System	-	-	(6,629)	(5,653)
Endowment return used for operations	4,798	4,632	-	-
Investment income	10,457	7,909	-	-
Investment and endowment income used for operations	-	-	11,590	7,039
Interest expense, net	(5,704)	(5,161)	(29)	(2)
Net Nonoperating Revenue	214,966	204,189	10,165	2,638
Income Before Other Changes in Net Assets	16,193	8,232	7,093	87
OTHER CHANGES IN NET ASSETS				
State of Maine capital appropriations	10,084	12,500	-	-
Capital grants and gifts	7,859	4,756	-	-
Endowment return, net of amount used for operations	11,206	5,155	12,495	4,678
True and quasi endowment gifts	217	411	20,860	8,894
Gain (loss) on disposal of capital assets	(2,269)	2,821	-	-
Total Other Changes in Net Assets	27,097	25,643	33,355	13,572
Increase in Net Assets	43,290	33,875	40,448	13,659
NET ASSETS				
Net Assets - beginning of year	588,538	554,663	163,220	149,561
Net Assets - end of year	$ 631,828	$ 588,538	$ 203,668	$ 163,220

See accompanying notes to basic financial statements

UNIVERSITY OF MAINE SYSTEM
Statements of Cash Flows
Years Ended June 30, 2007 and 2006
($ in thousands)

	2007 University of Maine System	2006 University of Maine System
CASH FLOWS FROM OPERATING ACTIVITIES:		
Tuition, residence, dining, and other student fees	$ 198,877	$ 179,625
Grants and contracts	151,722	135,272
Educational sales and services and other auxiliary enterprise revenues	55,456	59,955
Payments to and on behalf of employees	(391,092)	(367,305)
Financial aid paid to students	(20,342)	(14,708)
Payments to suppliers	(175,300)	(171,494)
Loans issued to students	(10,104)	(9,036)
Collection of loans to students	8,170	8,398
Interest collected on loans to students	571	551
Net Cash Used For Operating Activities	(182,042)	(178,742)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
State appropriations	192,119	184,688
Noncapital grants and gifts	12,786	12,400
Agency transactions	2,904	2,024
Net Cash Provided By Noncapital Financing Activities	207,809	199,112
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from capital debt issuances and escrow restructurings	47,135	69,136
Capital appropriations	10,472	12,072
Capital grants and gifts	5,344	3,039
Acquisition and construction of capital assets	(75,420)	(49,172)
Issuance costs on capital debt	(344)	(552)
Principal paid on capital debt and leases	(20,906)	(15,282)
Interest paid on capital debt and leases	(6,076)	(4,402)
Net Cash Provided by (Used For) Capital and Related Financing Activities	(39,795)	14,839
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and maturities of investments	439,103	390,200
Purchases of investments	(446,004)	(426,642)
Earnings from investments	14,192	8,312
Net Cash (Used For) Provided By Investing Activities	7,291	(28,130)
Net change in cash and cash equivalents	(6,737)	7,079
Cash and cash equivalents - beginning of year	8,378	1,299
Cash and cash equivalents - end of year	$ 1,641	$ 8,378

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM
Statements of Cash Flows
Years Ended June 30, 2007 and 2006
($ in thousands)

Reconciliation of operating loss to net cash used for operating activities:

	2007 University of Maine System	2006 University of Maine System
Operating loss	$ (198,773)	$ (195,957)
Adjustments to reconcile net operating loss to net cash used by operating activities:		
Depreciation and amortization	21,412	20,325
Changes in assets and liabilities:		
Accounts and grants receivable, net	1,856	(13,554)
Inventories and prepaid expenses	(1,435)	(126)
Notes receivable, net	(1,170)	(26)
Accounts payable	2	5,452
Deferred revenue and deposits	(1,087)	(863)
Accrued liabilities	(2,626)	6,404
Grants refundable	(221)	(397)
Net cash used for operating activities	$ (182,042)	$ (178,742)

Noncash investing, capital, and financing activities:

	2007	2006
Capital asset additions included in accounts payable as of June 30	$ 7,499	$ 6,638
Capital asset additions acquired through capital leases	$ 1,415	$ 178

See accompanying notes to basic financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

a. Organization

The University of Maine System ("the System"), a component unit of the State of Maine, consists of seven Universities, ten centers, and a central administrative office. All activities of the System are included in the accompanying financial statements, including those of its discretely presented component units (see Note 16). Those organizations are not-for-profit entities controlled by separate governing boards whose goals are to support the System. They receive funds primarily through donations and contribute funds to the System for student scholarships and institutional support.

b. Basis of Presentation

The accompanying financial statements of the System have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with U.S. generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB).

The System's policy for defining operating activities in the Statements of Revenues, Expenses, and Changes in Net Assets are those that generally result from exchange transactions such as payments received for services and payments made for the purchase of goods and services. Certain other transactions are reported as nonoperating activities in accordance with GASB Statement No. 35. These nonoperating activities include the System's operating and capital appropriations from the State of Maine, net investment income, gifts, and interest expense.

The System applies all pronouncements issued by the Financial Accounting Standards Board (FASB) on or before November 30, 1989, to the extent they do not conflict with GASB pronouncements.

c. Net Assets

The System's net assets (assets minus liabilities) are classified for accounting purposes in the following four categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, repair or improvement of those assets. It also includes the unamortized issuance costs and premiums/discounts related to the outstanding debt. This category excludes the portion of debt attributable to unspent bond proceeds.

Restricted – nonexpendable: Net assets subject to externally imposed conditions that the System maintain them in perpetuity.

Restricted – expendable: Net assets whose use is subject to externally imposed conditions that can be fulfilled by the actions of the System or by the passage of time.

Unrestricted: All other categories of net assets. Unrestricted net assets may be designated by actions of the System's Board of Trustees.

The System has adopted a policy of generally utilizing restricted – expendable resources, when available, prior to unrestricted resources.

d. Cash and Cash Equivalents

The System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

e. Investments

The System's investment in the State of Maine external investment pool is valued at amortized cost, which approximates fair value. All other investments are reported at fair value. University management is responsible for the fair measurement of investments reported in the financial statements. The System has implemented policies and procedures to assess the reasonableness of the fair values provided and believes that reported fair values at the balance sheet date are reasonable.

Endowment: The System follows the pooled investment concept for its endowed funds, whereby all invested funds are included in one pool, except for funds that are separately invested as directed by the donor. Investment income is allocated to each endowed fund in the pool based on its pro-rata share of the pool. Net assets categories are:

- **Restricted nonexpendable** : Net assets subject to externally imposed stipulations that they be maintained permanently. Such net assets include the historical gift value of restricted true endowment funds.
- **Restricted expendable** : Net assets whose use is subject to externally imposed stipulations. Such net assets include the accumulated net gains on true endowment funds, restricted gifts and income, and other similarly restricted funds.
- **Unrestricted :** Net assets are not subject to externally imposed stipulations.

As determined by policy, the income spending objective was 5% for FY2007 and FY2006. The income produced by the fund, including realized gains, can be used to meet this spending objective.

Authorized Investment Vehicles:

Short-term Investments: The System has a three-tiered approach regarding its short-term investments:

- Cash Pool – This tier is invested in a portfolio of highest quality short-term fixed-income securities (treasury obligations, agency securities, bankers acceptances, money market funds, CD's, commercial paper, short-term bond funds) with daily to 3-day liquidity. The average quality of the pool is at least "AA".

- Intermediate Pool – This tier is invested in a diversified portfolio, in accordance with investment manager guidelines, consisting primarily of fixed income securities with a normal average duration of 1 to 3 years. The average quality of the portfolio is at least "A-".

- Long-term Pool – This tier consists of funds that will not be required for at least 36 months. Assets should be diversified both by asset class and within asset classes. No minimum quality rating is specified for this pool, since it can invest in non-fixed income securities.

Endowment Investments: The fund will be diversified both by asset class and within asset classes. In order to have a reasonable probability of consistently achieving the Fund's return objectives, the following asset allocation policy has been adopted:

• Equity securities	50-70%
• Fixed income securities	17-27%
• Other	13-23%
• Cash	0-10%

Deposits with bond trustees: These monies are invested in accordance with the governing bond covenants and arbitrage certificates.

f. Inventories

Inventories are stated at cost. Cost is determined using the first-in, first-out method.

g. Gifts and Pledges

Gifts are recorded at their fair value at the date of gift. Promises to donate to the System are recorded as receivables and revenues when the System has met all applicable eligibility and time requirements. Gifts and bequests to be used for endowment purposes are categorized as endowment gifts. Other gifts are categorized as currently expendable. Since the System cannot fulfill the time requirement for gifts to endowments until the gift is received, pledges to endowments are not reported. Pledges receivable are reported net of amounts deemed uncollectible, and after discounting to the present value of the expected future cash flows. Because of uncertainties with regard to their realizability and valuation, bequests and intentions to give and other conditional promises are not recognized as assets until the specified conditions are met.

h. Grants and Contracts and Capital Appropriations

The System records a receivable and corresponding revenue for these funding sources at the point all eligibility requirements (e.g., allowable costs are incurred) are met.

i. Capital Assets

Capital assets are recorded at cost when purchased or constructed and at fair value at date of donation. In accordance with the System's capitalization policy, only equipment (including equipment acquired under capital leases) with a unit cost of $5 or more and capital projects with a projected cost of $50 or more are capitalized.

Interest costs on debt related to capital assets, net of investment income on unspent bond proceeds, are generally capitalized during the construction period. Software costs are capitalized and depreciated and include amounts paid to third parties and certain internal labor costs incurred to acquire and implement the software.

Depreciation and amortization of assets acquired under capital leases are recorded on a straight-line basis over the estimated useful lives of the related assets, principally as follows:

	Years
Buildings	30 - 60
Improvements	20 - 40
Equipment	5 - 15

Costs for maintenance, repairs and minor renewals and replacements are expensed as incurred; major renewals and replacements are capitalized. Equipment is removed from the financial statements during the fiscal year following the year they become fully depreciated. When land, buildings, and improvements are retired or otherwise disposed of, the asset and accumulated depreciation accounts are adjusted and any resulting gain or loss is reflected in the Statement of Revenues, Expenses, and Changes in Net Assets.

Prior to July 1, 2003, library materials were generally capitalized and depreciated over a ten-year period. Effective July 1, 2003, the System began expensing library materials as incurred. The System elected this change to enhance reporting comparability with other state systems. The System will retain the undepreciated library materials balance as a core non-depreciating asset.

The System does not capitalize and depreciate its collections of historical treasures and works of art because it is the System's policy that:

- Works of art and historical treasures are to be held for public exhibition, education, or research in furtherance of public service, rather than for financial gain.
- Works of art and historical treasures are to be protected, kept unencumbered, cared for, and preserved.
- The proceeds from sales of works of art and historical treasures are to be used to acquire other items for the collections.

j. Deferred Revenue and Deposits

Deferred revenue in the Statements of Net Assets consists primarily of grant and contract advances and deposits and advance payments received for tuition and fees related to certain summer programs and tuition received for the following academic year. Deferred revenue for summer programs is presented net of related expenses (e.g., student aid).

k. Compensated Absences

Employees earn the right to be compensated during absences for annual vacation leave. The accompanying Statements of Net Assets reflect an accrual for the amounts earned, including related benefits ultimately payable for such benefit. The System accounts for the vacation leave hours on a last-in, first-out basis. A portion of this liability is classified as current and represents the System's estimate of vacation time that will be paid during the next fiscal year to employees leaving the System.

l. Deferred Amounts on Refunding

Deferred amounts on refunding represent the difference between the reacquisition price and the carrying value of refunded revenue bonds. These amounts are amortized on a straight-line basis and charged to operations as additional interest expense over the shorter of the remaining life of the refunded bonds or the life of the new bonds. The unamortized portion is reported in the Statements of Net Assets as a reduction of bonds payable.

m. Net Student Fees

Student tuition, dining, residence, and other fees are presented net of scholarships and fellowships applied to students' accounts. Certain other scholarship amounts are paid directly to, or refunded to, the student and are generally reflected as expenses.

n. Tax Status

The System is exempt from income taxes under Section 115 of the Internal Revenue Code as a governmental entity. It has also been recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Code.

o. Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates in the financial statements include liabilities for self-insured plans, pension and other retirement benefit obligations, as well as allowances for uncollectible receivables. Actual results could differ from those estimates.

p. Reclassifications

Certain fiscal year 2006 items in the accompanying financial statements have been reclassified, without effect on total net assets, to conform to the fiscal year 2007 presentation.

2. CASH AND CASH EQUIVALENTS

Custodial credit risk is the risk that in the event of bank failure, the System's deposits may not be returned. The System carries deposits that are fully insured by FDIC insurance or collateralized with securities held by the System or the System's agent in the System's name. The System policy is that with the exception of daily operating cash, it will carry no deposits that are uncollateralized or uninsured. As of June 30, 2007 and 2006, the bank balances of uninsured and uncollateralized operating deposits totaled $3,504 and $3,178, respectively.

3. INVESTMENTS

Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures* requires that entities disclose essential risk information about their fixed income investments and external investment pools.

a. Composition and Purpose of Investments

The System's investments are composed of the following at June 30, 2007:

	Fair Value	Credit Rating	Interest Rate Risk	
Short-term Investments:				
Money funds, savings, CDs	$ 7,824			
Equities:				
Mutual funds - multi strategy	13,149			
Fixed Income:				
Mutual funds - bank loans	10,027	Not rated	.1 years	Duration
Mutual funds - bonds	41,216	Not rated	.71 - 5.76 years	Duration
Mutual funds - money market	10,164	Not rated	48 days	Ave maturity
State pool	54,993	Not rated	.22 years	Duration
Total	$ 137,373			
Deposits With Bond Trustees:				
Guaranteed investment contracts	$ 54,681	Not rated		
Money funds, savings, CDs	88			
Fixed Income:				
Mutual funds - bonds	147	Aaa-Moody's	19 days	Ave maturity
State pool	3,076	Not rated	.22 years	Duration
Total	$ 57,992			
Endowment Investments:				
Money funds, savings, CDs	$ 946			
Equities:				
Equities	38,800			
Mutual funds - equities	50,740			
Mutual funds - multi-strategy	9,915			
Fixed Income:				
Mutual funds - money markets	$ 39	Not rated	51 days	Ave maturity
Mutual funds - bonds	22,574	Not rated	4.1 - 4.4 years	Duration
Total	$ 123,014			

The System's investments and investment policies regarding the credit rating of its investments at June 30, 2006 are disclosed below.

	Fair Value	Credit Rating	Interest Rate Risk	
Short-term Investments:				
Money funds, savings, CDs	$ 22,918			
Equities:				
Mutual funds - multi strategy	11,619			
Fixed Income:				
Mutual funds - bank loans	5,438	Not rated	55 days	Weighted ave days
Mutual funds - bonds	37,154	Not rated	.16 - 7.03 years	Duration
State pool	50,337	Not rated	.18 years	Duration
Total	$ 127,466			
Deposits With Bond Trustees:				
Guaranteed investment contracts	$ 58,567	Not rated		
Money funds, savings, CDs	169			
Fixed Income:				
Mutual funds - bonds	140	Aaa-Moody's	1 day	Ave maturity
State pool	2,252	Not rated	.18 years	Duration
Total	$ 61,128			
Endowment Investments:				
Money funds, savings, CDs	$ 393			
Equities:				
Equities	32,501			
Mutual funds - equities	41,065			
Mutual funds - multi-strategy	8,626			
Fixed Income:				
Mutual funds - money market	4,054	Not rated	37 days	Ave maturity
Mutual funds - bonds	21,337	Not rated	4.41 - 4.24 years	Duration
Total	$ 107,976			

Short-term Investments: The System's short-term investments are available to fund operations or other purposes as determined by System management.

Endowment Investments: Except for certain gifts invested separately at the request of the donors ($172 and $157 at June 30, 2007 and 2006, respectively), the System's endowment is managed as a pooled investment fund by external investment advisors.

The University of Maine at Farmington Alumni Foundation, the University of Maine at Fort Kent Foundation, the University of Southern Maine Foundation, and the John L. Martin Scholarship Fund, Inc. have elected to participate in the System's endowment pool through a management agreement. The fair values of these investments at June 30, 2007 and 2006, respectively are $11,570 and $8,132, and are reported as funds held for others in the accompanying Statements of Net Assets.

Under State of Maine law, the System may spend realized and unrealized appreciation on endowments in addition to earnings on the funds. It is the System's policy (see Note 1.e) to spend a portion of the endowment earnings on operations and reinvest the balance. The reinvested earnings are presented as other changes in net assets. Total Endowment accumulated income and gains available to the System for spending is as follows at June 30:

	2007	2006
Restricted - expendable	$54,280	$44,357
Unrestricted	8,050	7,053
Total available for spending	$62,330	$51,410

Deposits With Bond Trustees: Deposits with bond trustees are composed of debt service reserves required by bond covenants and unexpended revenue bond proceeds.

b. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Short-term Investments: To limit interest rate exposure, the System diversifies the maturity/duration of its investments as specified in Note 1.e.

Endowment Investments: To limit interest rate exposure, the Endowment investment policy restricts:

- The average effective duration of the investment grade fixed income portfolio to no more than 1 year greater than the duration of the Lehman Brothers Aggregate Bond Index which is 4.72 years and 4.8 years at June 30, 2007 and 2006, respectively.
- The average effective duration for the high yield bond portfolio to no more than 1 year greater than the duration of the Citigroup BB/B Bond Index which is 4.1 years and 4.7 years at June 30, 2007 and 2006, respectively.

Deposits with Bond Trustees*:* These monies are invested in accordance with governing bond covenants and arbitrage certificates.

c. Foreign Currency Risk

Short-term Investments: Several of the mutual funds in which the System invests include holdings in various foreign currencies, with some funds hedging against forein currency risk. Foreign currency holdings represent 3% or less of the total dollar value of short-term investments at June 30, 2007 and 2006.

Endowment Investments: University policy is that up to 10% of the endowment portfolio may be invested in international bonds and currency exposure may be hedged or unhedged. Additionally, 15% of the total portfolio may be invested in a diversified portfolio of international equities, which may be hedged or unhedged at the investment manager's discretion.

Foreign currency holdings in bonds and equities represent less than 15% of the dollar value of endowment investments at June 30, 2007 and 2006.

Deposits with Bond Trustees may be invested in accordance with the governing bond covenants and arbitrage certificates.

d. Investment Income

Income related to the System's investments is as follows:

	2007				
	Net Gains	Interest and Dividends	Investment Fees	Capitalized Earnings	Net Earnings
Endowment investments	$ 10,413	$ 6,396	$ (805)	$ -	$ 16,004
Short-term investments	$ 2,665	$ 8,312	$ (825)	$ -	$ 10,152
Deposits with bond trustees	-	2,031	-	(1,726)	305
Total other investment income	$ 2,665	$ 10,343	$ (825)	$ (1,726)	$ 10,457

	2006				
	Net Gains	Interest and Dividends	Investment Fees	Capitalized Earnings	Net Earnings
Endowment investments	$ 6,403	$ 4,187	$ (803)	$ -	$ 9,787
Short-term investments	$ 1,209	$ 6,564	$ (512)	$ -	$ 7,261
Deposits with bond trustees	-	2,225	-	(1,577)	648
Total other investment income	$ 1,209	$ 8,789	$ (512)	$ (1,577)	$ 7,909

4. ACCOUNTS, GRANTS, AND PLEDGES RECEIVABLE

Accounts, grants, and pledges receivable include the following at June 30:

	2007			2006		
	Total	Current Portion	Noncurrent Portion	Total	Current Portion	Noncurrent Portion
Student and other accounts receivable	$ 16,210	$ 15,270	$ 940	$ 13,951	$ 13,000	$ 951
Grants receivable	30,326	28,220	2,106	35,041	32,564	2,477
Pledges receivable	4,605	809	3,796	4,293	834	3,459
Total gross receivables	51,141	44,299	6,842	53,285	46,398	6,887
Less allowance for doubtful accounts	(2,448)	(2,232)	(216)	(2,484)	(2,221)	(263)
Less discount on pledges receivable	(434)	-	(434)	(383)	-	(383)
Total receivables, net	$ 48,259	$ 42,067	$ 6,192	$ 50,418	$ 44,177	$ 6,241

In accordance with GASB 35, grants receivable related to the acquisition of capital assets are reported as a noncurrent receivable even though collection is expected within the next twelve months.

5. NOTES RECEIVABLE

Notes receivable include the following at June 30:

	2007			2006		
	Total	Current Portion	Noncurrent Portion	Total	Current Portion	Noncurrent Portion
Perkins Loans	$ 33,953	$ -	$ 33,953	$ 33,600	$ -	$ 33,600
Nursing Loans	1,574	-	1,574	1,355	-	1,355
Institutional Loans	5,909	-	5,909	5,136	-	5,136
Loans to Foundation **(a)**	217	61	156	2,129	489	1,640
Total notes receivable	41,653	61	41,592	42,220	489	41,731
Less allowance for doubtful accounts	(792)	-	(792)	(617)	-	(617)
Total notes receivable, net	$ 40,861	$ 61	$ 40,800	$ 41,603	$ 489	$ 41,114

Collections of the notes receivable for Perkins, Nursing, and Institutional loans may not be used to pay current liabilities, as the proceeds are restricted for making new loans. Accordingly, these notes receivable are recorded in the accompanying Statements of Net Assets as noncurrent assets.

(a) Loans to Foundation consist of the following:

	2007	2006
Quarterly payments at a variable rate. Paid in full in 2007. Secured by a mortgage on property adjacent to the University of Southern Maine campus.	$ -	$ 1,716
Quarterly payments at 4% per annum. Payable in full by July 2011. Secured by pledges receivable.	217	413
	$ 217	$ 2,129

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2007 is as follows:

	Beginning Balance	Additions	Reclasses	Retirements	Ending Balance
Land	$ 12,414	$ 951	$ 89	$ -	$ 13,454
Library Materials	25,686	-	-	-	25,686
Construction in Progress	39,783	71,362	(28,850)	-	82,295
Total Nondepreciable Assets	77,883	72,313	(28,761)	-	121,435
Land Improvements	34,021	-	1,583	(161)	35,443
Buildings & Improvements	542,725	1,555	20,801	(3,502)	561,579
Equipment	71,669	7,319	6,377	(12,508)	72,857
Total Depreciable Assets	648,415	8,874	28,761	(16,171)	669,879
Less Accumulated Depreciation:					
Land Improvements	19,900	1,323	-	(157)	21,066
Buildings & Improvements	155,747	12,439	-	(1,677)	166,509
Equipment	31,378	7,520	-	(12,068)	26,830
Total Accumulated Depreciation	207,025	21,282	-	(13,902)	214,405
Net Depreciable Assets	441,390	(12,408)	28,761	(2,269)	455,474
Total Capital Assets	$ 519,273	$ 59,905	$ -	$ (2,269)	$ 576,909

Capital asset activity for the year ended June 30, 2006 is as follows:

	Beginning Balance	Additions	Reclasses	Retirements	Ending Balance
Land	$ 12,366	$ -	$ 48	$ -	$ 12,414
Library Materials	25,686	-	-	-	25,686
Construction in Progress	48,446	48,682	(57,345)	-	39,783
Total Nondepreciable Assets	86,498	48,682	(57,297)	-	77,883
Land Improvements	32,311	-	1,842	(132)	34,021
Buildings & Improvements	497,713	911	45,538	(1,437)	542,725
Equipment	68,414	7,209	9,917	(13,871)	71,669
Total Depreciable Assets	598,438	8,120	57,297	(15,440)	648,415
Less Accumulated Depreciation:					
Land Improvements	18,573	1,409	-	(82)	19,900
Buildings & Improvements	144,995	11,547	-	(795)	155,747
Equipment	37,881	7,243	-	(13,746)	31,378
Total Accumulated Depreciation	201,449	20,199	-	(14,623)	207,025
Net Depreciable Assets	396,989	(12,079)	57,297	(817)	441,390
Total Capital Assets	$ 483,487	$ 36,603	$ -	$ (817)	$ 519,273

Additions to capital assets for the years ended June 30 include the following:

	2007	2006
Capitalized interest costs	$ 2,645	$ 2,657
Capitalized interest earnings	$(1,726)	$(1,577)
Assets acquired through capital leases	$1,415	$ 178

As of June 30, 2007 and 2006, $54,937 and $58,081, respectively, in proceeds from revenue bond issuances remain unspent. These amounts are included in the accompanying Statements of Net Assets as part of deposits with bond trustees.

Also remaining unspent as of June 30, 2007 is $5,151 in capital appropriations awarded by the State of Maine. These amounts are not included in the accompanying financial statements because the System has not met all eligibility requirements, e.g., incurred costs.

Both the revenue bond and capital appropriation monies are earmarked for specific projects, most of which are capital construction projects. As monies are spent on these projects the costs are included in capital assets in the accompanying Statements of Net Assets.

Outstanding commitments on uncompleted construction contracts total $39,596 at June 30, 2007.

7. LONG-TERM LIABILITIES

Changes in long-term liabilities during the year ended June 30, 2007 consist of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Capital lease obligations **(a)**	$ 587	$ 1,415	$ (890)	$ 1,112	$ 346
Bonds and note payable **(b)**	195,797	47,135	(20,265)	222,667	6,453
Total leases and bonds payable	196,384	48,550	(21,155)	223,779	6,799
Accrued liabilities:					
Workers' compensation - Note 11	5,650	1,619	(1,416)	5,853	1,427
Health insurance - Note 11	4,401	54,898	(54,433)	4,866	4,866
Other employee benefit programs - Note 13	34,357	53,452	(51,230)	36,579	3,801
Other	18,361	12,273	(18,000)	12,634	12,225
Total accrued liabilities	62,769	122,242	(125,079)	59,932	22,319
Total long-term liabilities	$ 259,153	$ 170,792	$ (146,234)	$ 283,711	$ 29,118

Changes in long-term liabilities during the year ended June 30, 2006 consist of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Capital lease obligations **(a)**	$ 656	$ 178	$ (247)	$ 587	$ 223
Bonds and note payable **(b)**	141,871	69,136	(15,210)	195,797	6,329
Total leases and bonds payable	142,527	69,314	(15,457)	196,384	6,552
Accrued liabilities:					
Workers' compensation - Note 11	5,624	2,004	(1,978)	5,650	1,377
Health insurance - Note 11	4,195	53,194	(52,988)	4,401	4,401
Other employee benefit programs - Note 13	32,853	40,001	(38,497)	34,357	3,496
Other	13,786	17,969	(13,394)	18,361	17,968
Total accrued liabilities	56,458	113,168	(106,857)	62,769	27,242
Total long-term liabilities	$ 198,985	$ 182,482	$ (122,314)	$ 259,153	$ 33,794

(a) Lease Obligations

The System leases certain equipment and real estate under leases with terms exceeding one year. The rent expense related to these operating leases amounted to $2,383 for the year ended June 30, 2007 and $2,071 for the year ended June 30, 2006.

Future minimum lease payments under capital leases and under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2007 are as follows:

	Capital Leases		Operating	
Year Ending June 30,	Principal	Interest	Leases	Total
2008	$ 346	$ 39	$ 1,504	$ 1,889
2009	283	28	697	1,008
2010	208	17	427	652
2011	179	8	97	284
2012	96	2	97	195
2013-2017	-	-	77	77
2018-2022	-	-	33	33
2023-2027	-	-	2	2
Total minimum lease payments	$1,112	$ 94	$ 2,934	$ 4,140

The net book value of capital assets acquired through capital leases are reported in the following capital asset categories as of June 30:

	2007	2006
Land	$ 609	$ -
Buildings	69	71
Equipment	1,144	1,247
	$ 1,822	$ 1,318

(b) Bonds Payable

Bonds payable consist of the following at June 30:

	2007	2006
2007 Series A Revenue Bonds (original principal of $46,740)		
Serial bonds, maturing from 2008 to 2037, with annual principal payments from $195 to $3,380 and coupon interest rates from 4.0% to 5.0%. Issued to partially refund the 1998A and 2004A Series Revenue Bonds and to provide funding for capital projects.	$ 46,740	$ -
Add: unamortized premium	786	-
Less: unamortized deferred amount on refunding of 1998A and 2004A bonds	(841)	-
Total 2007 Series A Bonds	46,685	-
2005 Series A Revenue Bonds (original principal of $69,125)		
Serial bonds, maturing from 2006 to 2035, with annual principal payments from $75 to $3,455 and coupon interest rates from 3.5% to 5.0%. Issued to partially refund the 1998A, 2000A, 2002A, and 2003A Series Revenue Bonds and to provide funding for capital projects.	68,630	69,050
Add: unamortized premium	436	451
Less: unamortized deferred amount on refunding of 1998A, 2000A, 2002A, and 2003A bonds	(449)	(526)
Total 2005 Series A Bonds	68,617	68,975
2004 Series A Revenue Bonds (original principal of $43,270)		
Serial bonds, maturing from 2005 to 2029, with annual principal payments from $335 to $5,080 and coupon interest rates from 2.0% to 5.0%. Issued to partially refund the 1998A and 2000A Series Revenue Bonds and to provide funding for capital projects.	35,240	36,070
4.25% Term Bonds, due March 1, 2034	6,410	6,410
Add: unamortized premium	1,955	2,233
Less: unamortized deferred amount on refunding of 1998A and 2000A bonds	(1,026)	(1,412)
Total 2004 Series A Bonds	42,579	43,301
2003 Series A Revenue Bonds (original principal of $19,970)		
Serial bonds, maturing from 2004 to 2032, with annual principal payments from $145 to $1,610 and coupon interest rates from 3.0% to 4.75%. Issued to refund the 1993A and 1993B Series Revenue Bonds.	13,860	15,205
Add: unamortized premium	138	152
Less: unamortized deferred redemption fee on 1993 bonds	(211)	(244)
Total 2003 Series A Bonds	13,787	15,113
2002 Series A Revenue Bonds (original principal of $43,020)		
Serial Bonds, maturing from 2002 to 2012, with annual principal payments from $310 to $1,525 and coupon interest rates from 2.0% to 5.375%. A balloon payment of $31,915 is due in 2012.	37,535	38,785
Add: unamortized premium	1,395	1,660
Total 2002 Series A Bonds	38,930	40,445

	2007	2006
2000 Series A Revenue Bonds (original principal of $41,725)		
Serial Bonds, maturing from 2001 to 2015, with annual principal payments from $1,490 to $4,465 and coupon interest rates from 4.5% to 5.75%.	$ 8,190	$ 8,075
5.50% Term Bonds, due March 1, 2030	-	1,985
Add: unamortized premium	27	34
Total 2000 Series A Bonds	8,217	10,094
1998 Series A Revenue Bonds (original principal of $29,540)		
Serial Bonds, maturing from 2000 to 2011, with annual principal payments from $660 to $1,050 and coupon interest rates from 3.95% to 4.75%.	3,930	4,810
5.00% Term Bonds, due March 1, 2018	-	2,880
5.00% Term Bonds, due March 1, 2024	-	10,540
Less: unamortized discount	(78)	(361)
Total 1998 Series A Bonds	3,852	17,869
Total bonds payable, net	$ 222,667	$ 195,797

Costs associated with the issuance of revenue bonds have been reported in the accompanying Statements of Net Assets as bond issuance costs, net and are being amortized over the life of the related bond issuance as part of depreciation and amortization expense. The discounts and the premiums on the revenue bonds are also being amortized over the life of the respective bond issuances as part of interest expense using the effective interest method.

Principal and interest payments on bonds and note payable for the next five years and in subsequent five-year periods are as follows at June 30, 2007:

Year Ending June 30:	Principal	Interest	Total
2008	$ 7,060	$ 9,546	$ 16,606
2009	7,475	9,985	17,460
2010	7,885	9,675	17,560
2011	8,325	9,352	17,677
2012	39,225	8,981	48,206
2013-2017	37,520	31,018	68,538
2018-2022	34,810	22,750	57,560
2023-2027	32,125	14,867	46,992
2028-2032	32,920	7,485	40,405
2033-2037	13,190	1,290	14,480
	$ 220,535	$ 124,949	$ 345,484

Interest costs related to the Revenue Bonds for fiscal year 2007 and fiscal year 2006 were $8,306 and $7,785, respectively. These amounts are net of savings of $290 and $290, respectively, from an interest swap on the 2002 Series A Revenue Bonds – see Note 8. Of the total interest costs, $2,645 and $2,657 was capitalized as part of capital assets for the respective years ended June 30, 2007 and 2006 – see Note 6.

Refunding of Debt – FY2007

On June 28, 2007, the System issued 2007 Series A Revenue Bonds to advance refund portions of the 2004 and 1998 Series A Revenue Bonds in the amount of $13,750 and to fund new capital projects. The System completed the refunding to reduce its total debt service payments over the following twenty-seven years by $310 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $375. The principal amount of debt refunded through in-substance defeasance and still outstanding at June 30, 2007 was $13,750.

Refunding bond proceeds of $14,146 were placed in an escrow account to pay the interest due on the refunded bonds and to retire the bonds on their respective maturity dates which range from FY2008 thru FY2010. The escrow account is invested to yield enough earnings to pay required future payments which are $22,995 as of June 30, 2007.

The FY2007 refunding resulted in a deferred amount on refunding of $841 which represents the difference between the reacquisition price and the carrying value of the refunded bonds. Amortization of this deferred amount on refunding will be charged to operations as additional interest expense through the year 2009. The unamortized portion of the deferred amount on refunding, which is $841 as of June 30, 2007 is reported in the accompanying Statements of Net Assets as a reduction of the 2007 Series A Revenue Bonds.

Refunding of Debt – FY2006

On November 3, 2005, the System issued 2005 Series A Revenue Bonds to advance refund portions of the 2003, 2002, 2000 and 1998 Series A Revenue Bonds in the amount of $8,800 and to fund new capital projects. The System completed the refunding to reduce its total debt service payments over the following twenty-six years by $555 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $444. The principal amount of debt refunded through in-substance defeasance and still outstanding at June 30, 2007 and 2006 are $8,635 and $8,720, respectively.

Refunding bond proceeds of $9,249 were placed in an escrow account to pay the interest due on the refunded bonds and to retire the bonds on their respective maturity dates which range from FY2006 thru FY2010. The escrow account is invested to yield enough earnings to pay required future payments which are $9,999 and $10,547 as of June 30, 2007 and 2006, respectively.

The FY2006 refunding resulted in a deferred amount on refunding of $576 which represents the difference between the reacquisition price and the carrying value of the refunded bonds. Amortization of this deferred amount on refunding will be charged to operations as additional interest expense through the year 2028. The unamortized portion of the deferred amount on refunding, which is $449 and $526 as of June 30, 2007 and 2006, respectively, is reported in the accompanying Statements of Net Assets as a reduction of the 2005 Series A Revenue Bonds.

Refunding of Debt – Prior Years

Prior to FY2006, the System defeased certain revenue bonds by placing the proceeds of new bonds in an escrow account to provide for all future debt service payments on the old bonds. This transaction met the requirements of an "in-substance defeasance" as defined by U.S. generally accepted accounting principles, and as a result, neither the escrow account nor the liability for the refunded bonds is included in the accompanying Statements of Net Assets. On June 30, 2007 and 2006, $18,975 of bonds outstanding are considered defeased.

8. INTEREST RATE SWAP

As a means to lower its borrowing costs, the System entered into an interest rate swap in connection with the issuance of its $43,020 Series A Revenue Bonds (see note 7) in June 2002. The purpose of the agreement was to swap the fixed rate on the underlying debt for a variable rate for the term of the debt, and not for any speculative purposes.

In an effort to maximize total savings, the System terminated the swap on April 1, 2004 for a net gain of $2,291, which is being amortized over the remaining life of the related 2002 Series A Revenue Bonds. The unamortized amount as of June 30, 2007 and 2006 was $1,349 and $1,639, respectively and is included in deferred revenue and deposits in the accompanying Statements of Net Assets.

9. GOVERNMENT ADVANCES REFUNDABLE

The System participates in the Federal Perkins Loan and Nursing Loan Programs. These programs are funded through a combination of Federal and Institutional resources. The portion of these programs that has been funded with Federal funds is ultimately refundable to the U.S. Government upon the termination of the System's participation in the programs. The portion that would be refundable if the programs were terminated as of June 30, 2007 and 2006 has been included in the accompanying Statements of Net Assets as a noncurrent liability.

10. NET ASSETS

The System's net assets are composed of the following as of June 30:

	2007	2006
Invested in capital assets, net of related debt	$ 396,244	$ 379,235
Restricted - Nonexpendable:		
Endowment funds	48,864	48,153
Restricted - Expendable:		
Student financial aid	40,331	33,100
Capital assets and retirement of debt	18,102	18,021
Loans	11,689	11,078
Academic support	10,070	7,894
Research and public service	7,607	8,876
Library	2,835	2,849
Other	20,229	17,596
Total restricted - expendable	110,863	99,414
Unrestricted		
Educational and general	28,751	24,056
Auxiliary enterprises	9,404	7,744
Retiree medical	7,574	5,089
Administrative system implementation	5,968	5,968
Internally designated projects	8,857	6,803
Facility projects & capital planning	8,050	7,053
Funds functioning as endowment	6,627	5,974
Cost sharing and other	626	(951)
Total unrestricted	75,857	61,736
Total net assets	$ 631,828	$ 588,538

11. COMMITMENTS AND CONTINGENCIES

The System participates in a number of federal programs subject to financial and compliance audits. The amount of expenditures that may be disallowed by the granting agencies cannot be determined at this time, although the System does not expect these amounts, if any, to be material to the financial statements.

The System is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries; and natural disasters. The System manages these risks through a combination of participation in a public entity risk pool, commercial insurance policies purchased in the name of the System, a self-insurance program for workers' compensation claims, and a retention program for physical damage to vehicles and mobile equipment.

The System's annual retention obligation for general liability is capped at $400, plus a $5 per claim deductible once the retention obligation is met. Educator's legal liability risks are subject to a $100 per loss retention with no annual cap. The System's estimate of the amount payable under these retention levels has been included in the accompanying Statements of Net Assets as part of current accrued liabilities. As of June 30, 2007 and 2006 certain legal claims existed for which the probability or amount of payment could not be determined. The System, however, does not expect these amounts, if any, to be material to the financial statements.

The System participates in a public entity risk pool with the State of Maine. The System pays an annual premium to the State of Maine for its property and boiler insurance coverage. The risk pool is self- sustaining through member premiums and reinsures through commercial companies for claims in excess of coverage provided by the fund. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

It is the policy of the System not to purchase primary commercial insurance for the risk of loss related to workers' compensation. Instead, the System's management believes it is more economical to manage its risk internally and to set aside assets for claims settlement. The liability for unpaid claims is based on the requirements of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The System's estimated liability for workers' compensation claims is included in accrued liabilities in the accompanying Statements of Net Assets (see note 7). The System purchases commercial specific and aggregate excess workers' compensation insurance which limits the exposure for any one incident to $1,000 and provides coverage in the event that total claims exceed expectations.

The System's health insurance plan is financed through a minimum premium contract with a commercial carrier. The contract in effect at June 30, 2007 ends December 31, 2007. The plan allows the System to benefit from favorable claims experience, should paid claims be less than the maximum claim liability under the contract. As of June 30, 2007 and 2006, the System's paid claims for the six months then ended had not reached the maximum claim liability amount for the same six month period. Under a traditional premium arrangement, a component of the premium paid to the insurance carrier each month covers the terminal liability, or claims incurred during the period of coverage but not paid until after the period of coverage. However, under this minimum premium contract, the System retains the terminal liability component until the contract is terminated. As of June 30, 2007 and 2006, the estimated liability for claims incurred but not reported was $4,104 and $4,401, respectively, and is part of the total health insurance liability included in accrued liabilities in the accompanying Statements of Net Assets (see note 7).

The System continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

12. UNEXPENDED GRANTS

Generally, grants and contracts awarded to the System, but for which it has not fulfilled the eligibility requirements (e.g., incur allowable costs) are not included in the System's financial statements. The total of such awards as of June 30, 2007 and 2006 was $41,779 and $48,447, respectively.

In certain circumstances, however, the System receives cash in advance of fulfilling its obligations. In such situations the System reports the cash as an asset and reports offsetting deferred revenue in the Statements of Net Assets. Outstanding advances as of June 30, 2007 and 2006 totaled $8,238 and $9,528, respectively.

13. PENSION PLANS

The System has several single-employer pension plans, each of which is described in more detail below. The System's pension expense (income) for each of these plans was as follows for the years ended June 30:

	2007	2006
Faculty and Professional Employees:		
Contributory Retirement Plan	$ 18,673	$ 16,988
Incentive Plan	2,119	2,024
Classified Employees:		
Basic Retirement Plan	3,349	3,024
Defined Benefit Plan	(380)	(258)
Total net pension expense	$ 23,761	$ 21,778

Faculty and Professional Employee Plans

Contributory Retirement Plan

Eligible salaried employees participate in the University of Maine System Retirement Plan for Faculty and Professional Employees (Contributory Plan), a defined contribution retirement plan administered by the Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF). The Board of Trustees and collective bargaining agreements establish mandatory employee and employer contribution rates.

All full-time employees are eligible once employment begins. Part-time employees are eligible upon achieving the equivalent of five years of continuous, full-time, regular service. All eligible employees are required to participate when they reach thirty years of age. The System contributes an amount equal to 10% of each participant's base salary, and each participant contributes 4% of base salary. Participant and System contributions are fully and immediately vested. Participants may direct up to 100% of existing accumulations and/or future contributions to selected investment vehicles outside of TIAA/CREF. Upon separation from the System, participants may withdraw up to 100% of their account balances, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Contributory Plan.

Employee contributions made to the Contributory Plan were $7,478 in FY2007 and $6,800 in FY2006.

Incentive Retirement Plan

Employees enrolled in the Contributory Plan may elect to retire at any age after 55. Such employees, except for represented faculty who became employed on or after July 1, 1996 and other professional employees who became employed on or after July 1, 2006, also participate in the University of Maine System Incentive Retirement Plan (Incentive Plan), a defined benefit plan, which was established on July 1, 1975. The Board of Trustees has authority to establish and amend provisions under the Incentive Plan. The Incentive Plan provides that eligible retiring employees with at least 10 years of continuous regular service immediately prior to retirement will receive a benefit equivalent to 1.5% of their final annual base salary for each completed year of service up to a maximum of 27 years. This amount is to be paid as a lump-sum contribution to the participant's TIAA or CREF account. Employees do not make contributions under the Incentive Plan.

The Incentive Plan, which is funded on a termination basis (i.e., when costs become due and payable), holds no assets. Actuarial valuations, utilizing the projected unit credit actuarial cost method and 30-year declining-period, dollar amortization, were most recently performed as of July 1, 2006 and 2005. Interest was assumed to compound at an annual rate of 6.25% and salaries were assumed to increase at an annual rate of 3.5%.

Summarized below are the actuarial liability and actuarial value of assets at July 1:

	2006	2005
Actuarial value of assets	$ -	$ -
Actuarial accrued liability	21,034	20,271
Unfunded actuarial accrued liability	$ (21,034)	$ (20,271)

The net pension obligation (NPO) represents the cumulative difference between annual pension cost and employer contributions to the plan. The NPO is included in the accompanying Statements of Net Assets in noncurrent accrued liabilities (see other employee benefit programs in Note 7). Three-year trend information through June 30, 2007, which provides an indication of the progress made in accumulating sufficient assets to pay benefits when they become due, is as follows:

	(a)	(b)	(c)	(d) (a)+(b)-(c)	(e)	(f) (e)/(d)	(g) (d)-(e)	
Fiscal Year Ended June 30	Annual Required Contribution (ARC)	Interest on NPO	ARC Adjustment	Annual Pension Cost (APC)	Employer Contributions Made	Percentage of APC Contributed	Change in NPO	Ending NPO Balance
2007	$ 2,501	$ 984	$ 1,366	$ 2,119	$ 960	45%	$ 1,159	$16,897
2006	$ 2,356	$ 926	$ 1,258	$ 2,024	$ 1,106	55%	$ 918	$15,738
2005	$ 2,521	$ 876	$ 1,165	$ 2,232	$ 1,434	65%	$798	$14,820

Classified Employees

Basic Retirement Plan

The Defined Contribution Program of the Basic Retirement Plan for Classified Employees (Basic Plan) was created on July 1, 1998 in accordance with Section 403(b) of the Internal Revenue Code. Classified employees hired July 1, 1998 or later participate in the Basic Plan. Most eligible employees who were hired before July 1, 1998 and who were younger than age 50 as of June 30, 1998 rolled over to the Basic Plan the value of their accrued benefit in the Defined Benefit Retirement Plan for Classified Staff (Defined Benefit Plan, as described further below), which until that time was the primary pension plan for classified employees. Eligible employees who were hired before July 1, 1998 and were age 50 or older on June 30, 1998 could elect to roll over to the Basic Plan the value of their accrued benefit in the Defined Benefit Plan or remain in the Defined Benefit Plan.

Full-time employees are eligible to participate in the Basic Plan once employment begins. Part-time employees are eligible once they have achieved the equivalent of five years of continuous, full-time regular service. Upon separation from the System, participants may withdraw up to 100% of their account balances, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Basic Plan.

Employees hired July 1, 1998 or later are required to contribute at least 1% and may contribute up to 4% of base pay to the Basic Plan. Their contributions are matched 100% by the System. Employees hired prior to July 1, 1998 and who have less than five years of completed service may voluntarily contribute up to 4% of base pay and receive a 100% match from the System.

Employees who (1) have five or more years of completed service and (2) do not participate in the Defined Benefit Plan automatically receive System contributions equal to 6% of their base pay. These employees may also voluntarily contribute 1% to 4% of their base pay and receive a 100% match from the System.

Employee contributions made to the Basic Plan were $1,551 in FY2007 and $1,440 in FY2006.

Defined Benefit Plan

The Defined Benefit Plan is maintained for eligible employees who chose not to join the Basic Plan. Normal retirement benefits are paid to participants who attain age 65 and retire. The monthly retirement benefit is based on a formula specified by policy in collective bargaining agreements.

Early retirement benefits are paid to participants who retire upon the attainment of age 55 and who have completed five years of continuous service. The benefit is computed in accordance with the normal retirement benefit, but is reduced by an actuarial factor because benefits will be paid over a longer period of time. No reduction is made if an employee retires after attaining 62 years of age with 25 or more years of service. Deferred vested benefits are paid to participants who have attained five or more years of continuous service. Participants are also eligible for disability and death benefits.

The Defined Benefit Plan holds investment assets consisting principally of equities, bonds and cash equivalents to fund benefits. At June 30, 2007 and 2006, these assets exceeded the Defined Benefit Plan's actuarial accrued liability. Because the Defined Benefit Plan is a separate trust, its assets and liabilities are not included in the accompanying financial statements. The actuarial accrued liability is a standardized measure representing the actuarial present value of credited projected pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits estimated to be payable in the future, as a result of employee service rendered to date. An actuarial valuation, utilizing the projected unit credit actuarial cost method and 10-year level amortization, was most recently performed as of July 1, 2006 and 2005. Interest was assumed to compound at an annual rate of 6.5%, and salaries were assumed to increase at annual rate of 3.5%.

Summarized below are the accrued actuarial liability and actuarial value of assets at July 1:

	2006	2005
Actuarial value of assets	$ 59,521	$ 58,988
Actuarial accrued liability	52,974	53,024
Overfunded actuarial accrued liability	$ 6,547	$ 5,964

Employees who participate in the Defined Benefit Plan may also participate in the Optional Retirement Savings Plan (ORSP). The ORSP is a voluntary, employee-funded defined contribution plan. Employees may contribute up to 4% of their base pay and receive a 100% match from the System. The ORSP is administered by TIAA-CREF.

Funding of Basic and Defined Benefit Plans

While the Basic Plan and Defined Benefit Plan are administratively separate, they are both part of the Retirement Plan for Classified Employees and covered by the same plan document. In accordance with Section 414(k) of the Internal Revenue Code, the System may elect to fund employer contributions to the Basic Plan and ORSP from excess assets in the Defined Benefit Plan, subject to certain limitations. During fiscal years 2007 and 2006, the System elected not to use the excess Defined Benefit Plan assets in this manner.

The NPO balance of the Defined Benefit Plan at transition was zero, since all actuarially determined required contributions were made by the System prior to that date. Annual required contributions and other metrics shown below accordingly reflect the funded status of the Defined Benefit Plan, as well as expected benefits attributable to the Basic Plan and ORSP.

Three-year trend information through June 30, 2007, including changes in the NPO, was as follows:

Fiscal Year Ended June 30	(a) Annual Required Contribution (ARC)	(b) Interest on NPO	(c) ARC Adjustment	(d) (a)+(b)-(c) Annual Pension Cost (APC)	(e) Employer Contributions Made	(f) (e)/(d) Percentage of APC Contributed	(g) (d)-(e) Change in NPO	Ending NPO Balance
2007	$ (409)	$ (26)	$ (55)	$ (380)	$ -	-	$ (380)	$ (773)
2006	$ (268)	$ (9)	$ (19)	$ (258)	$ -	-	$ (258)	$ (393)
2005	$ (153)	$ 2	$ 10	$ (161)	$ -	-	$ (161)	$ (135)

As of June 30, 2007 and 2006, the NPO is included in the accompanying Statement of Net Assets as part of accounts, grants, and pledges receivable.

14. POSTEMPLOYMENT HEALTH PLAN

The System provides postemployment health insurance to retirees meeting certain age and years-of-service requirements. As of June 30, 2007 and 2006 , there were approximately 1,800 persons (including widows/widowers) receiving postemployment health benefits.

The System subsidizes the cost of insurance for the following persons:

- Retired from the System with at least 10 years of full-time regular service and has reached age 65 or

- A former employee approved for long-term disability benefits regardless of age or service

The subsidy for those meeting the above requirements is 100% of the cost for the retiree and 50% of the costs for eligible dependents. With certain restrictions, dependents are eligible to continue coverage at the 50% rate after the death of a retiree meeting the above criteria. As of both June 30, 2007 and 2006 there were approximately 1,650 persons receiving a subsidy from the System.

The following persons may also participate in the System's health insurance plan after retirement; however, they must pay 100% of the cost for themselves and their dependents:

- Retired from the System with at least 10 years of full-time regular service and has reached age 55 but is under age 65 **or**
- Retired from the System at age 65 or older but had not met the years of service requirement

As of June 30, 2007 and 2006, there were approximately 115 and 110 persons, respectively, participating in the plan but not receiving a subsidy from the System.

Health insurance coverage for eligible persons is provided as part of the System's regular health insurance contract. Persons eligible for a subsidy from the System may not convert their benefit into an in-lieu payment to secure coverage under independent plans.

The System finances the postemployment health plan on a pay-as-you-go basis. Total gross costs for the year ended June 30, 2007 and 2006 were $11,150 and $11,200, respectively, with the participants contributing $2,700 and $2,500, respectively toward the costs.

15. PASS THROUGH GRANTS

During fiscal year 2007 and 2006, the System distributed $13,259 and $12,568, respectively, for student loans through the U.S. Department of Education Federal Direct Lending Program. These distributions and related funding sources are not included as expenses and revenues nor as cash disbursements and cash receipts in the accompanying financial statements.

16. COMPONENT UNITS

The System is supported in part by several foundations and alumni associations that raise funds on the System's behalf. The System determined that two of those entities meet the criteria under GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units,* for inclusion as discretely presented component units of the System and, accordingly, has presented them in the accompanying financial statements as of and for the years ended June 30, 2007 and 2006.

The discretely presented component units are private, not-for-profit organizations that report under FASB standards, including FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, and FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. The financial presentation of the discretely presented component units has been reclassified to conform to the System's GASB presentation.

The System's major discretely presented component unit is the University of Maine Foundation ("the Foundation"), which is a legally separate, tax-exempt organization that acts primarily as a fund-raising organization to supplement the resources that are available to the System in support of its programs. The board of directors of the Foundation is self-perpetuating and independent of the System's Board of Trustees. Although the System does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon that the Foundation holds and invests are restricted to the activities of the System by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the System (specifically the University of Maine), the Foundation is considered a component unit of the System and is discretely presented in the System's financial statements.

Condensed financial information of the Foundation is as follows as of and for the year ended June 30:

	2007	2006
Assets		
Current assets	$ 3,036	$ 2,390
Noncurrent assets	185,829	145,144
Total Assets	$ 188,865	$ 147,534
Liabilities and Net Assets		
Current liabilities	$ 117	$ 85
Noncurrent liabilities	7,194	4,633
Total Liabilities	7,311	4,718
Net Assets:		
Invested in capital assets, net of related debt	75	52
Restricted nonexpendable	118,881	100,779
Restricted expendable	50,316	36,918
Unrestricted	12,282	5,067
Total Net Assets	181,554	142,816
Total Liabilities and Net Assets	$ 188,865	$ 147,534

	2007	2006
Operating Revenues	$ -	$ -
Operating Expenses	2,421	1,930
Operating Loss	(2,421)	(1,930)
Nonoperating Revenues (Expenses)		
Payments to the System	(6,461)	(5,496)
Other nonoperating revenues	16,120	7,618
Net Nonoperating Revenue	9,659	2,122
Income Before Other Changes in Net Assets	7,238	192
Other Changes in Net Assets	31,500	12,712
Increase in Net Assets	38,738	12,904
Net assets, beginning of year	142,816	129,912
Net assets, end of year	$ 181,554	$ 142,816

Complete financial statements for the Foundation in its FASB format can be obtained from the Foundation's offices at Two Alumni Place, Orono, ME 04469-5792.

UNIVERSITY OF MAINE SYSTEM
Required Supplemental Information – Retirement Plans
Schedules of Funding Progress, Employers' Contributions, and Related Note
Year ended June 30, 2007
(Unaudited)
($ in thousands)

Schedules of Funding Progress

Actuarial valuation (date as of July 1)	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll (b-a)/(c)
Incentive Retirement Plan for Faculty and Professionals						
2006	$ —	$ 21,034	$ 21,034	—	$ 134,672	15.6%
2005	$ —	$ 20,271	$ 20,271	—	$ 135,017	15.0%
2004	$ —	$ 21,219	$ 21,219	—	$ 130,216	16.3%
2003	$ —	$ 19,980	$ 19,980	—	$ 127,531	15.7%
2002	$ —	$ 17,824	$ 17,824	—	$ 100,463	17.7%
2001	$ —	$ 15,371	$ 15,371	—	$ 96,599	15.9%
Retirement Plan for Classified Staff - Classified Plan Only						
2006	$ 59,521	$ 52,974	$ (6,547)	112.4%	$ 4,203	(155.8%)
2005	$ 58,988	$ 53,024	$ (5,964)	111.2%	$ 6,235	(95.7%)
2004	$ 59,248	$ 56,804	$ (2,444)	104.3%	$ 7,279	(33.6%)
2003	$ 59,087	$ 53,831	$ (5,256)	109.8%	$ 8,770	(59.9%)
2002	$ 62,257	$ 51,618	$ (10,639)	120.6%	$ 9,276	(114.7%)
2001	$ 64,672	$ 50,475	(14,197)	128.1%	$ 9,730	(145.9%)

Schedules of Employers' Contributions

Year ended June 30	Annual required contribution	Percentage contributed	Annual required contribution	Percentage contributed
	Incentive Retirement Plan for Faculty and Professionals		Retirement Plan for Classified Staff	
2007	$ 2,501	38%	$ (409)	—
2006	$ 2,356	47%	$ (268)	—
2005	$ 2,521	57%	$ (153)	—
2004	$ 2,330	30%	$ (620)	—
2003	$ 2,073	25%	$ 741	—
2002	$ 1,768	75%	$ 81	—

Note to Schedules

The information presented in the required supplementary schedules as of June 30, 2007 was determined using the actuarial valuation as of July 1, 2006 with the following significant assumptions:

	Incentive Retirement Plan for Faculty and Professionals	Retirement Plan for Classified Staff
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method	30-year declining period, level dollar	10-year level dollar
Remaining amortization period	20 years	1 year
Asset valuation method	N/A	5-year smoothing of differences between actual and expected returns
Actuarial assumptions:		
Investment rate of return	6.25%	6.50%
Projected salary increases	3.50%	3.50%
Cost-of-living adjustments	N/A	N/A

UNIVERSITY OF MAINE SYSTEM
Supplemental Information Required by the State of Maine
Schedules of Activities
($ in thousands)

Year Ended June 30, 2007

Schedule 1

Functions/Programs	Expenses	Charges for Services	Operating Grants/ Contributions	Capital Grants/ Contributions	Net (Expense) Revenue
University of Maine System	$ 610,265	$ 256,887	$ 178,201	$ 7,859	$ (167,318)
General Revenues:					
Unrestricted interest and investment earnings					10,457
Additions to endowments - gifts					217
State of Maine noncapital appropriation					192,119
State of Maine capital appropriation					10,084
Loss on disposal of capital assets					(2,269)
Total Revenues and Extraordinary Items					210,608
Change in Net Assets					43,290
Net Assets, Beginning of Year					588,538
Net Assets, End of Year					$ 631,828

Year Ended June 30, 2006

Schedule 2

Functions/Programs	Expenses	Charges for Services	Operating Grants/ Contributions	Capital Grants/ Contributions	Net (Expense) Revenue
University of Maine System	$ 596,327	$ 247,111	$ 170,006	$ 4,756	$ (174,454)
General Revenues:					
Unrestricted interest and investment earnings					7,909
Additions to endowments - gifts					411
State of Maine noncapital appropriation					184,688
State of Maine capital appropriation					12,500
Gain on disposal of capital assets					2,821
Total Revenues and Extraordinary Items					208,329
Change in Net Assets					33,875
Net Assets, Beginning of Year					554,663
Net Assets, End of Year					$ 588,538

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
University of Maine System:

We have audited the financial statements of the business-type activities and aggregate discretely presented component units of the University of Maine System (the System), a component unit of the State of Maine, as of and for the year ended June 30, 2007, which collectively comprise the System's basic financial statements, and have issued our report thereon dated October 26, 2007, which included a reference to the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters did not include the entities audited by the other auditors referred to in the previous paragraph. The findings, if any, of the other auditors are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the System's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the System's internal control.

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Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We noted certain matters that we reported to management of the System in a separate letter dated October 26, 2007.

This report is intended solely for the information and use of the Audit Committee, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 26, 2007